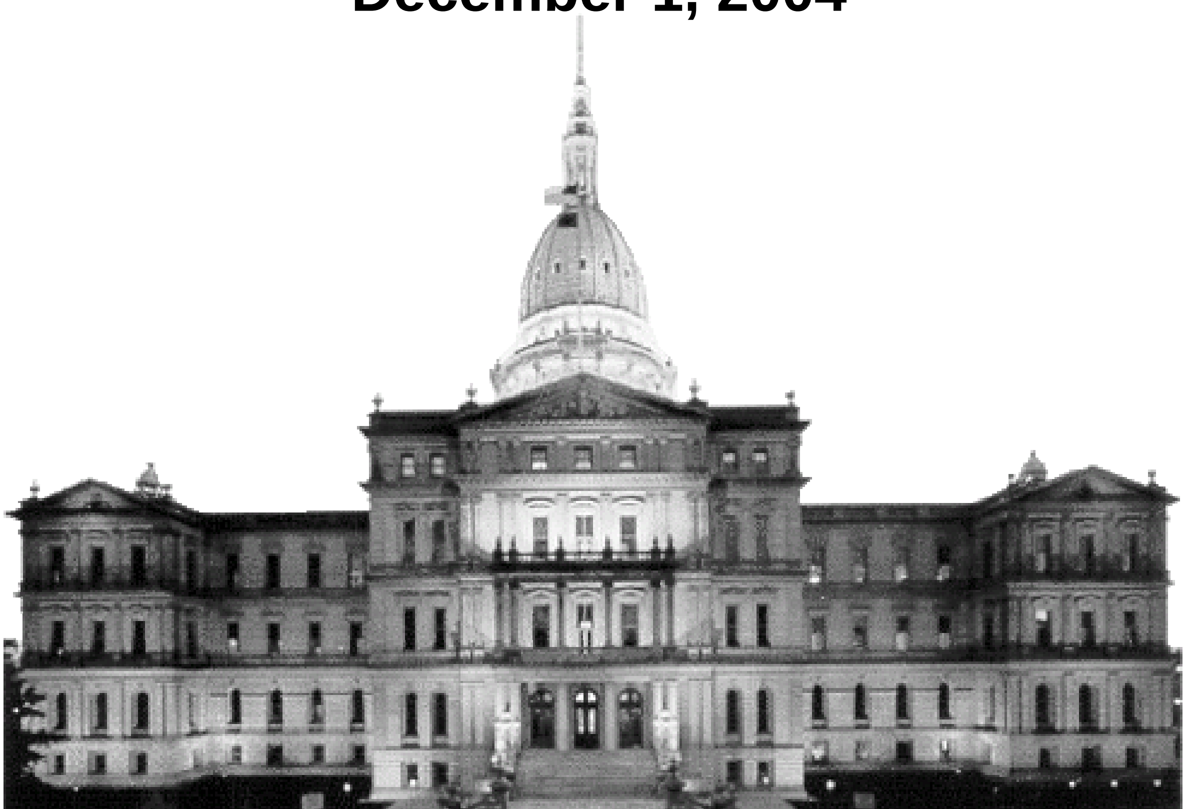
Senate Fiscal Agency

MICHIGAN'S ECONOMIC OUTLOOK AND BUDGET REVIEW

FY 2003-04 and FY 2004-05 REVISED

December 1, 2004



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THE SENATE FISCAL AGENCY

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1. To provide technical, analytical, and preparatory support for all appropriations bills.
2. To provide written analyses of all Senate bills, House bills and Administrative Rules considered by the Senate.
3. To review and evaluate proposed and existing State programs and services.
4. To provide economic and revenue analysis and forecasting.
5. To review and evaluate the impact of Federal budget decisions on the State.
6. To review and evaluate State issuance of long-term and short-term debt.
7. To review and evaluate the State's compliance with constitutional and statutory fiscal requirements.
8. To prepare special reports on fiscal issues as they arise and at the request of members of the Senate.

The Agency is located on the 8th floor of the Victor Office Center. The Agency is an equal opportunity employer.

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EXECUTIVE SUMMARY

ECONOMIC FORECAST

The U.S. economy, as measured by inflation-adjusted gross domestic product, will increase at an estimated rate of 4.3% in 2004 and 3.1% in 2005. Light vehicle sales will total 16.8 million units in 2004 and 16.9 million units in 2005. The unemployment rate will be at 5.5% in both 2004 and 2005.

The Michigan economy, as measured by inflation-adjusted personal income, will increase at an estimated rate of 0.9% in 2004 and 1.7% in 2005. Wage and salary employment will decline 1.1% in 2004 and remain flat in 2005.

REVENUE FORECAST

General Fund/General Purpose (GF/GP) and School Aid Fund (SAF) revenue totaled an estimated $18.52 billion in fiscal year (FY) 2003-04, which is down $15 million from the May 2004 consensus estimate. In FY 2004-05, GF/GP and SAF revenue will total an estimated $18.67 billion, which is down $443 million from the previous estimate.

General Fund/General Purpose revenue totaled an estimated $7.97 billion in FY 2003-04, which was only $2 million below the May 2004 estimate. In FY 2004-05, GF/GP revenue is expected to total $7.85 billion. This revised estimate is down $271 million from the previous estimate.

School Aid Fund revenue totaled an estimated $10.55 billion in FY 2003-04. This represents a downward revision of a slight $13 million from the May 2004 estimate. In FY 2004-05, SAF revenue will total an estimated $10.82 billion, which is $172 million below the previous estimate.

YEAR-END BALANCE ESTIMATES

Based on a review of revenue and expenditure data as of November 30, 2004, the Senate Fiscal Agency (SFA) is estimating that the FY 2003-04 GF/GP budget will close the fiscal year with a $21.7 million balance. Pursuant to statutory requirements, this year-end balance will be transferred to the Budget Stabilization Fund. Based on the revised revenue estimates and enacted and projected appropriations in FY 2004-05, the SFA is estimating that the FY 2004-05 GF/GP budget is in deficit by $345.5 million.

Based on a review of revenue and expenditure data as of November 30, 2004, the SFA is estimating that the FY 2003-04 SAF budget will close the fiscal year with a $35.5 million deficit. For FY 2004-05, the combination of the carry-forward deficit from FY 2003-04, the revised revenue estimate, and enacted appropriations leads to a projected $232.4 million FY 2004-05 SAF deficit. Pursuant to statutory requirements, this projected SAF deficit could be eliminated with a $131 pro-rata reduction in State payments to local school districts.

ECONOMIC REVIEW AND OUTLOOK

State revenue, particularly from taxes, depends heavily on economic conditions. This section presents the Senate Fiscal Agency's latest economic forecast for 2004 and 2005, as well as a summary of recent economic activity.

RECENT ECONOMIC HIGHLIGHTS

Although the United States economy has been growing for three years, since the trough of the 2001 recession, employment growth has been hampered by a sustained increase in productivity and a variety of other economic shocks, particularly in energy prices. While inflation-adjusted Gross Domestic Product (GDP) grew at an annual rate of 3.0% during 2003, wage and salary employment declined at an annual rate of 0.3%. Since 2003, the economy has grown more rapidly and employment has begun to increase. On a seasonally adjusted basis, wage and salary employment in October 2004 was 2.4% above the average level for 2003.

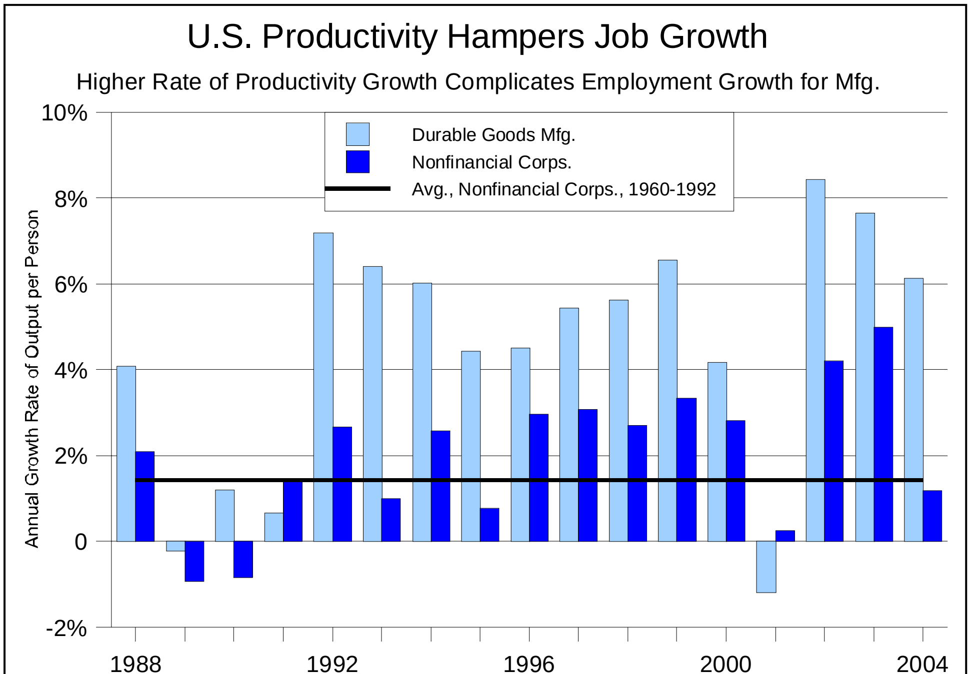
Michigan's economy, particularly the Michigan job market, declined even more drastically than did the national economy. Michigan wage and salary employment peaked in June 2000, nine months before the national recession began. Michigan wage and salary employment appears to have reached a trough in July 2004, although subsequent changes in wage and salary employment have been mixed and it remains below the June 2004 level. Between November 2001, when the national recession officially ended, and July 2004, the Michigan economy lost 147,000 jobs–the most lost by any state in the nation--and experienced a 3.3% decline in employment since November 2001. With the job picture in Michigan, inflation-adjusted Michigan personal income has struggled, falling 1.6% in 2002 and rising only 2.1% in 2003. Adjusted for seasonality, the Michigan economy lost approximately 340,000 jobs between June 2000 and July 2004, a 7.3% decline. Preliminary October 2004 wage and salary employment data place Michigan up by 23,000 jobs from July 2004.

Michigan's recession began nine months before the national recession and it is unclear if a sustained recovery has begun. Personal income growth has lagged behind the national average and wage and salary employment may continue falling, although currently it appears to have bottomed out in July 2004. The reason Michigan has struggled so much compared with other states involves the economic changes occurring in certain sectors of the economy combined with Michigan's industrial mix. Nationally, job losses during the recession were more severe, compared with the drop in inflation-adjusted GDP, than in previous recessions primarily because of substantial increases in productivity. Similarly, job growth during the recovery has been slowed by continued high productivity. As seen in Figure 1, productivity has been increasing rapidly in recent years, particularly in durable goods manufacturing, a sector in which Michigan industry is disproportionately concentrated.

Productivity provides a number of positive economic benefits, including lower product prices and greater income growth in the future. However, productivity offers a transitory negative economic effect with its impact on job growth. For example, with stable sales, an 8% increase in productivity in one year (such as that experienced in durable goods manufacturing over the 2002-2003 period) means that a firm could reduce its labor force by 8% that year and still produce the output needed to meet demand. In the case of Michigan's largest industry—transportation equipment manufacturing--total sales of light vehicles have fallen (almost 3% between 2001 and 2003) and domestic vehicle sales have comprised a decreasing share of total sales (from 83.5% in 2000 to an estimated 79.0% in 2005). In 2001, Michigan represented 3.2% of the national economy, yet produced 5.2% of manufacturing goods and 6.9% of durable goods. Approximately one-half of

Michigan's durable goods manufacturing employment is in transportation equipment manufacturing, and employment in Michigan motor vehicle manufacturing employment comprises nearly one-third of the nation's motor vehicle manufacturing employment.

Figure 1



Source: Bureau of Labor Statistics, U.S. Department of Labor.

While more difficult to quantify, many of Michigan's nonmanufacturing sectors rely heavily, either directly or indirectly, on activity in the motor vehicle sector. Average wages in transportation equipment manufacturing are higher than in any other economic sector in Michigan, workers in the sector will purchase goods and services across the spectrum for their own consumption, and vehicle manufacturers are significant consumers of a variety of goods and services as well. As a result, economic downturns (from either declining employment or declining business profits) in the vehicle sector are transmitted and multiplied throughout the Michigan economy, just as any national or local economic shock is transmitted through the affected economies.

The factors affecting job growth over the last few years are expected to continue to affect the economy over the forecast period. The primary factors affecting the economy, and which present risks to the forecast, reflect: 1) strong productivity growth; 2) declines or weak growth in business and consumer confidence, particularly with regard to current high expectations for the economy that are unlikely to be realized; 3) consumption growth being hampered by high debt burdens, particularly once interest rates begin rising, and significant incentives to increase saving; 4) production overcapacity; and 5) weak growth in exports.

FORECAST SUMMARY

Both the U.S. and Michigan economies are expected to continue growing in 2005 (Figure 2). Table 1 and Table 2 provide a summary of key economic indicators from the SFA's economic forecast, with references to recent years. Inflation-adjusted GDP is projected to grow by 4.3% in 2004 and 3.1% in 2005, after rising 3.0% in 2003. Most of the higher growth in 2004 reflects improvements in business investment and increases in inventory accumulation. Government expenditures will continue to contribute to economic activity in 2004, although less so than during the recession, as increases in government spending continue to add nearly one-half percentage point to economic growth. Slower growth in 2005 will reflect a stable rate of inventory accumulation, flat residential investment, and a slight decline in consumption growth. The unemployment rate will decline to 5.5% during 2004 and remain at that level through 2005.

Table 1

THE SENATE FISCAL AGENCY ECONOMIC FORECAST
(Calendar years)

United States	**2001 Actual**	**2002 Actual**	**2003 Actual**	**2004 Estimate**	**2005 Estimate**
Nominal GDP					
(year-to-year growth)	3.2%	3.5%	4.9%	6.5%	5.5%
Inflation-adjusted GDP					
(year-to-year growth)	0.8%	1.9%	3.0%	4.3%	3.1%
Unemployment rate	4.7%	5.8%	6.0%	5.5%	5.5%
Inflation					
Consumer Price Index					
(year-to-year growth)	2.8%	1.6%	2.3%	2.7%	2.6%
GDP Implicit price deflator					
(year-to-year growth)	2.4%	1.7%	1.8%	2.1%	2.3%
Interest rates					
90-day Treasury bill	3.40%	1.61%	1.01%	1.36%	2.69%
Corporate Aaa bond	7.08%	6.49%	5.66%	5.63%	5.79%
Federal funds rate	3.88%	1.67%	1.13%	1.34%	3.18%
Light motor vehicle sales					
(millions of units)	17.1	16.8	16.6	16.8	16.9
Auto	8.4	8.1	7.6	7.5	7.5
Truck	8.7	8.7	9.0	9.3	9.4
Michigan					
Personal Income (millions)	$299,284	$302,019	$314,460	$323,046	$336,929
Year-to-year growth	1.7%	0.9%	4.1%	2.7%	4.3%
Inflation-adjusted personal income (year-to-year growth)	(1.0)%	(1.6)%	2.1%	0.9%	1.7%
Wage & salary income (millions)	$173,085	$173,339	$176,493	$177,432	$182,744
year-to-year growth	(1.3)%	0.1%	1.8%	0.5%	3.0%
Detroit Consumer Price Index					
(year-to-year growth)	2.7%	2.6%	2.0%	1.8%	2.6%
Wage & Salary Employment					
(thousands)	4,555.9	4,477.8	4,411.8	4,364.6	4,362.9
year-to-year growth	(2.5)%	(1.7)%	(1.5)%	(1.1)%	0.0%
Unemployment Rate	5.3%	6.2%	7.3%	6.7%	7.1%

Table 2

THE SENATE FISCAL AGENCY U.S. ECONOMIC FORECAST DETAIL (Calendar Years)	2001 Actual	2002 Actual	2003 Actual	2004 Estimate	2005 Estimate
Gross Domestic Product					
(billions of dollars)	$10,128.0	$10,487.0	$11,004.0	$11,717.5	$12,365.5
Year-to-year growth	3.2%	3.5%	4.9%	6.5%	5.5%
Inflation-Adjusted GDP and Components					
Gross Domestic Product					
(billions of 2000 dollars)	$9,890.7	$10,074.8	$10,381.3	$10,830.6	$11,169.5
Year-to-year growth	0.8%	1.9%	3.0%	4.3%	3.1%
Consumption					
(billions of 2000 dollars)	$6,910.4	$7,123.4	$7,355.6	$7,623.6	$7,873.3
Year-to-year growth	2.5%	3.1%	3.3%	3.6%	3.3%
Business fixed investment					
(billions of 2000 dollars)	$1,180.5	$1,075.6	$1,110.8	$1,222.4	$1,330.4
Year-to-year growth	-4.2%	-8.9%	3.3%	10.0%	8.8%
Change in Business Inventories					
(billions of 2000 dollars)	($31.7)	$11.7	($0.8)	$46.9	$44.7
Residential investment					
(billions of 2000 dollars)	$448.5	$470.0	$511.2	$560.4	$555.4
Year-to-year growth	0.4%	4.8%	8.8%	9.6%	-0.9%
Government spending					
(billions of 2000 dollars)	$1,780.3	$1,857.9	$1,909.4	$1,949.3	$1,988.8
Year-to-year growth	3.4%	4.4%	2.8%	2.1%	2.0%
Net Exports					
(billions of 2000 dollars)	($399.1)	($472.1)	($518.5)	($584.3)	($626.8)
Exports (billions of 2000 dollars)	$1,036.7	$1,012.3	$1,031.8	$1,121.5	$1,193.7
Imports (billions of 2000 dollars)	$1,435.8	$1,484.4	$1,550.3	$1,705.7	$1,820.5
Personal income					
(year-to-year growth)	3.5%	1.8%	3.2%	5.0%	5.5%
Adjusted for Inflation	0.6%	0.2%	0.9%	2.2%	2.8%
Wage & salary income					
(year-to-year growth)	2.4%	0.7%	2.6%	4.4%	4.8%
Personal savings rate	1.8%	2.0%	1.4%	0.7%	0.4%
Capacity utilization rate	77.4%	75.6%	74.8%	77.0%	77.3%
Housing starts (millions of units)	1.603	1.705	1.848	1.943	1.868
Conventional mortgage rates	7.0%	6.4%	5.8%	5.8%	6.1%
Federal budget surplus					
(billions of dollars, NIPA basis)	$41.8	($276.8)	($407.6)	($395.1)	($375.2)

In Michigan, economic activity will mirror the national economy, although both job growth and personal income growth are expected to remain below average (Figures 2 and 3). Furthermore, the sectors exhibiting the largest gains in employment generally pay wages below those in the slowest-growth sectors (Figures 4 and 5). Inflation-adjusted personal income is expected to increase 0.9% in 2004 before increasing 1.7% in 2005, compared with a 2.1% increase in 2003. Wage and salary employment is forecasted to fall 1.1% in 2004 and to remain flat in 2005, although on a quarterly basis there will be improvements in job gains. Such job growth represents an improvement from the 2.5%, 1.7%, and 1.5% declines in wage and salary employment experienced in 2000, 2001, and 2002, respectively. Flat auto sales will combine with productivity improvements to increase the unemployment rate from 6.7% in 2004 to 7.1% in 2005, keeping it above the national average.

Figure 2

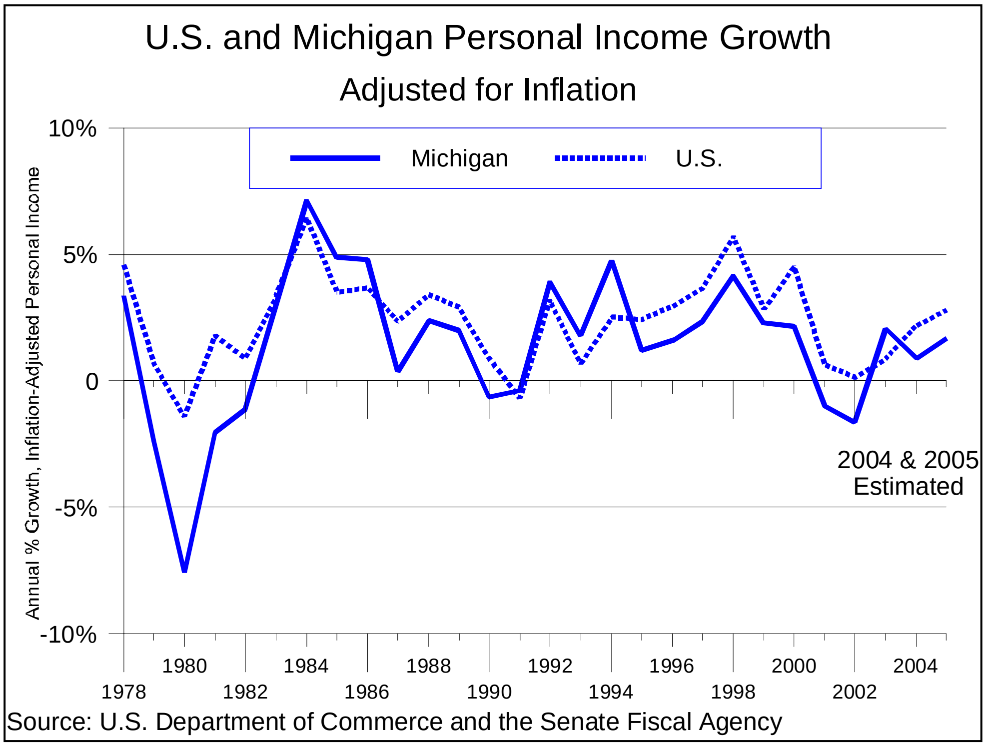


Figure 3

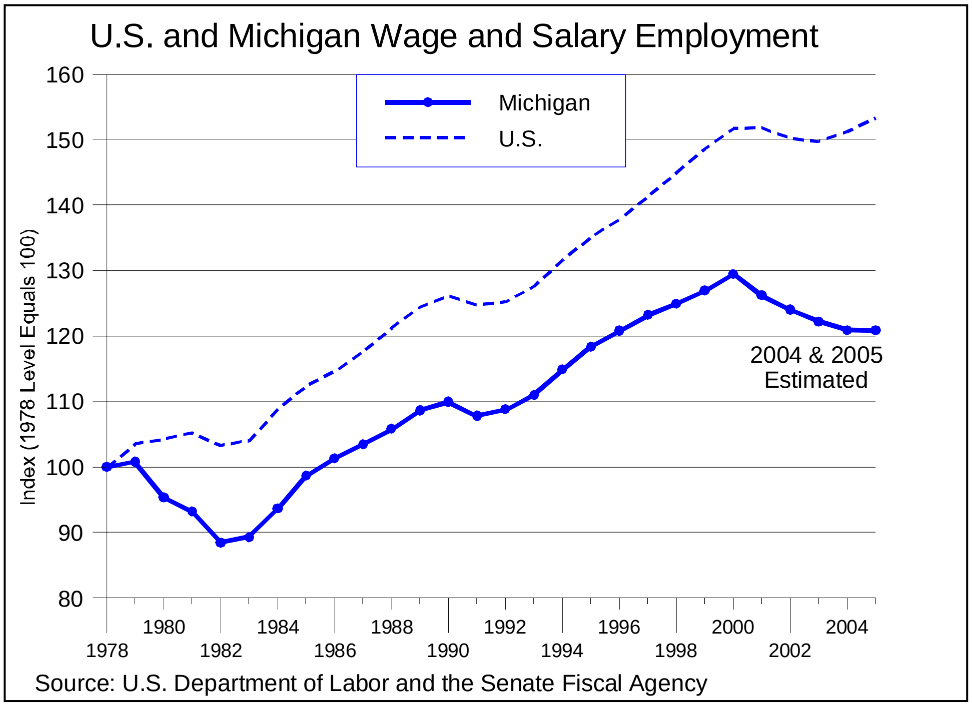


Figure 4

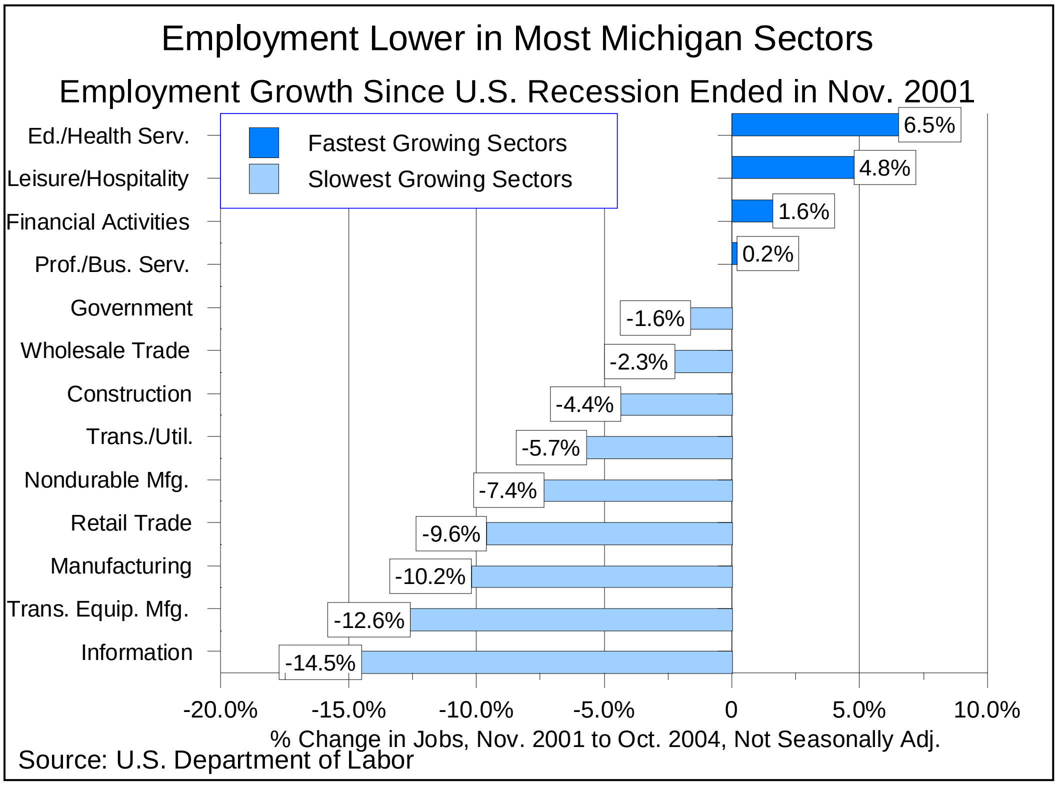
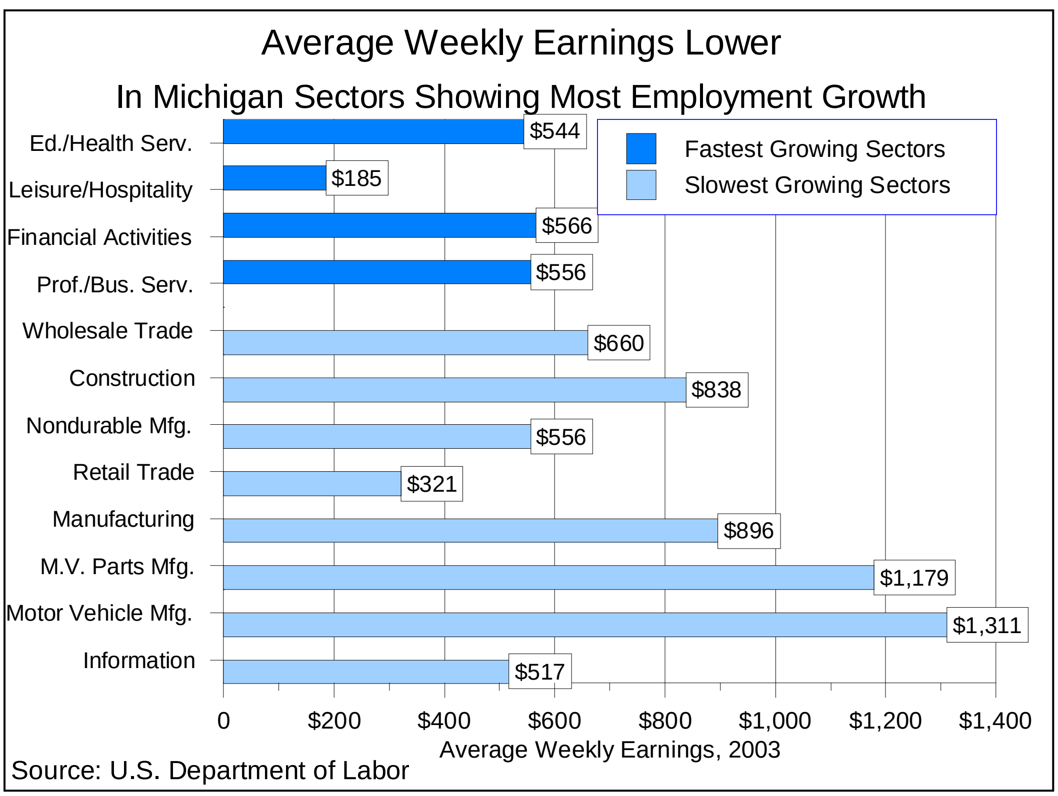


Figure 5



Compared with the May 2004 Consensus Economic Forecast, both the U.S. and Michigan economies are weaker in 2005. For example, the May estimates forecasted inflation-adjusted GDP to increase 4.6% in 2004 and 3.7% in 2005, compared with revised estimates of 4.3% and 3.1%, respectively. The light vehicle sales forecast remains essentially unchanged, although the composition of sales is more weighted toward imports. Light vehicle sales were estimated in May 2004 to total 16.7 million units in 2004 and 16.9 million units in 2005, compared with a revised forecast of 16.6 million units in 2004 and 16.8 million units in 2005. Similarly, the May 2004 forecast estimated that the U.S. unemployment rate would be 5.5% in 2004 and 5.3% in 2005, compared with a revised estimate of 5.5% in both years. For Michigan, the May forecast estimated that wage and salary employment would decline 0.6% in 2004 before rising 1.5% in 2005, compared with a revised estimate of a decline of 1.1% in 2004 and no meaningful change in 2005. The May forecast also estimated that personal income would rise 3.3% in 2004 and 5.8% in 2005 and that the unemployment rate would decline from 6.8% in 2004 to 6.5% in 2005, compared with the revised estimate of personal income growth of 2.7% in 2004 and 4.3% in 2005 and the unemployment rates increasing from 6.7% in 2004 to 7.1% in 2005.

BUDGET STABILIZATION FUND

Based on the Senate Fiscal Agency's revised economic forecast, it is estimated that the growth in personal income less transfer payments will not be strong enough to trigger a payment into the Budget Stabilization Fund (BSF) in FY 2004-05, as shown in Table 3. As a result, it is estimated that the balance in the BSF will remain at zero through FY 2004-05, as shown in Table 4.

Table 3

ESTIMATED ECONOMIC AND BUDGET STABILIZATION FUND TRIGGER
FY 2003-04 AND FY 2004-05
(millions of dollars)

	CY 2003	CY 2004	CY 2005
Michigan Personal Income (MPI)	$314,460	$323,046	$336,929
Less: Transfer Payments	46,874	48,907	51,683
Subtotal	$267,586	$274,139	$285,246
Divided by: Detroit CPI, 12 months average ending June 30 (1982-84=1)	1.814	1.837	1.884
Equals: Real Adjusted MPI	147,512	149,232	151,404
Percent Change from Prior Year		1.17%	1.46%
Excess Over 2%		0.00%	0.00%
Amount Under 0%		0.00%	0.00%
		FY 2003-04	**FY 2004-05**
Multiplied by: Estimated GF/GP Revenue		$7,968.2	$7,847.2
		FY 2003-04	**FY 2004-05**
Equals: Transfer from the BSF		$0.00	$0.00
OR Transfer to the BSF		$0.00	$0.00

Table 4

ECONOMIC AND BUDGET STABILIZATION FUND
TRANSFERS, EARNINGS AND FUND BALANCE
FY 1998-99 TO FY 2004-05
(millions of dollars)

Fiscal Year	Pay-In	Interest Earned	Pay-Out	Fund Balance
1998-99	$244.4	$51.2	$73.7	$1,222.5
1999-00	100.0	73.9	132.0	1,264.4
2000-01	0.0	66.7	337.0	994.2
2001-02	0.0	20.8	869.8	145.2
2002-03	9.1	1.8	156.1	0.0
SFA Estimates:				
2003-04	0.0	0.0	0.0	0.0
2004-05	0.0	0.0	0.0	0.0

THE FORECAST FOR STATE REVENUE

This section of the Economic Outlook and Budget Review provides revised estimates of General Fund/General Purpose (GF/GP) and School Aid Fund (SAF) revenue for FY 2003-04 and FY 2004-05. In general, the revenue estimates have been revised downward compared with earlier estimates. These earlier estimates include the May 2004 consensus estimates, the initial estimates of the recent tobacco and casino tax increases, and estimates of some other revenue adjustments that were adopted after the May 2004 Consensus Revenue Estimating Conference.

FY 2003-04

General Fund/General Purpose and SAF revenue totaled an estimated $18.5 billion in FY 2003-04, which was down 0.8% from the FY 2002-03 level. Compared with the previous estimates, total tax collections were down $146.0 million, but nontax revenue was up $130.0 million. As a result, total GF/GP and SAF revenue was down $15.0 million in FY 2003-04 compared with the previous estimates. The revised revenue estimates for FY 2003-04 are summarized in Table 5.

General Fund/General Purpose. Based on information available as of November 29, 2004, GF/GP revenue in FY 2003-04 totaled $8.0 billion, which was up 0.1% from the FY 2002-03 level. Compared with the previous revenue estimates, including the May 2004 consensus revenue estimate, FY 2003-04 revenue was down a slight $2.0 million. Tax collections earmarked to GF/GP revenue were down $124.0 million compared with the earlier estimates, but nontax revenue was up $122.0 million. The $124.0 million shortfall in tax collections was concentrated in the single business, insurance, and utility property taxes, along with the revenue from tax penalties and interest payments. The unexpected increase in nontax revenue included about $90 million in increases that were clearly one-time in nature.

School Aid Fund. Based on preliminary year-end data, SAF revenue totaled $10.5 billion, which was down 16% decline from FY 2002-03. School Aid Fund revenue fell in FY 2003-04 because revenue did not grow by enough to offset the $454.0 million one-time boost in State education property tax revenue in FY 2002-03. Compared with the previous revenue estimates, this revised SAF revenue estimate is down $14.0 million.

FY 2004-05

In FY 2004-05, GF/GP and SAF revenue will total an estimated $18.7 billion. While this revised estimate represents an 0.8% increase from the FY 2003-04 revised estimate, it is $443.0 million below the May 2004 consensus estimate. This downward revision in the FY 2004-05 revenue estimate is due to three major factors: 1) Tax collections in FY 2003-04 came in lower than expected by $146.0 million, so tax collections for FY 2004-05 will be building off of a lower base compared with the previous revenue estimate; 2) at least $90.0 million of the unexpected increase in nontax revenue realized in FY 2003-04 was one-time revenue and will not be available again in FY 2004-05; and 3) the pace of economic growth is now expected to be slower than was estimated in May 2004. These revised revenue estimates for FY 2004-05 are summarized in Table 6.

General Fund/General Purpose. It is estimated that GF/GP revenue will total $7.8 billion, which is below the revised estimate for FY 2003-04 by $121.0 million or 1.5%. Compared with the May 2004 consensus revenue estimate, this revised estimate for FY 2004-05 is down $271.0 million. Most of the downward revision is due to reductions in the estimates for income and single business tax revenue.

School Aid Fund. School Aid Fund earmarked tax and lottery revenue will total an estimated $10.8 billion in FY 2004-05. This revised estimate is up $270.0 million, or 2.6%, above the revised estimate for FY 2003-04; however, compared with the estimate adopted at the May 2004 Consensus Revenue Estimating Conference, this revised estimate is down $172.0 million. Most of this downward revision is due to reductions in the estimates for sales and income taxes.

GENERAL FUND AND SCHOOL AID FUND MAJOR TAXES

Revisions made in some of the major taxes earmarked to the GF/GP and/or the SAF are described below.

Income Tax. Income tax revenue totaled an estimated $5.85 billion in FY 2003-04, which was up only 0.8% from the FY 2002-03 level. Much of this weakness was due to the reduction in the tax rate from 4.0% to 3.9% on July 1, 2004, which represented the final scheduled reduction in the income tax rate, which fell from 4.4% to 3.9% over the past five years. If the tax rate had been the same as in FY 2002-03, income tax revenue would have been up 2.5% or an additional $95.0 million in FY 2003-04. In addition to the reduction in the tax rate, the ongoing weak job market had a negative impact on income tax collections in FY 2003-04. Compared with the May 2004 consensus estimate, income tax revenue was down $21.0 million. In FY 2004-05, income tax revenue will total an estimated $5.83 billion, which represents a 0.4% decline from the revised estimate for FY 2003-04. This modest decline reflects continued weakness in the Michigan job market and the impact of the tax rate being at 3.9% for the full fiscal year. Compared with the May 2004 consensus estimate, this revised estimate is down $212.0 million. In FY 2003-04 and FY 2004-05, the SAF will receive approximately 25% of gross income tax collections and the remaining income tax revenue will go to the General Fund.

Sales Tax. Based on preliminary final data, sales tax collections totaled $6.5 billion in FY 2003-04, which was up 0.8% or $54.0 million from FY 2002-03. This estimate of final sales tax revenue is $38.0 million below the estimate adopted in May 2004. In FY 2004-05, sales tax collections are expected to increase 3.2% or $209.0 million from the FY 2003-04 level, to $6.7 billion; however, compared with the May 2004 consensus estimate, this revised sales tax revenue estimate is down $138.0 million.

Single Business Tax. Michigan's major tax on business, the single business tax, generated an estimated $1.8 billion in FY 2003-04. This represented a decrease of 3.1%, or $57.0 million, from the FY 2002-03 level, and was $59.0 million below the estimate adopted in May 2004. In FY 2004-05, the modest improvement in economic activity forecast for 2005 is expected to help spur a 3.9% increase in single business tax revenue in FY 2004-05, to over $1.8 billion. Despite this projected increase from the revised FY 2003-04 level, the revised estimate for FY 2004-05 is down $97.0 million from the May consensus estimate.

State Education Property Tax. Based on preliminary year-end data, the State education property tax generated almost $1.8 billion in FY 2003-04. While this represented a 17.2% decline from the FY 2002-03 level, all of this decline can be attributed to the acceleration in the due date of the tax which went into effect in FY 2002-03. This change in the due date generated a one-time boost in tax collections totaling $454.0 million in FY 2002-03. Adjusting for this shift in the due date, State education property tax revenue was up about 2.2% in FY 2003-04. In FY 2004-05, State education property tax revenue is expected to increase 5.6%, to almost $1.9 billion.

Table 5

FY 2003-04 REVISED REVENUE ESTIMATES
GENERAL FUND/GENERAL PURPOSE AND SCHOOL AID FUND
(dollars in millions)

	FY 2002-03 Final	**FY 2003-04 Revised Estimate**	**Change from FY 2002-03: Dollar Change**	**Change from FY 2002-03: Percent Change**	**$ Change from 05/04 Consensus[1)]**
GENERAL FUND/GENERAL PURPOSE:					
Baseline Revenue	$7,943.6	$8,036.2	$ 92.6	1.2%	$ (39.8)
Tax Changes Not In Baseline	14.1	(68.0)	(82.1)	---	38.1
Revenue After Tax Changes:					
Personal Income Tax					
Gross Collections	7,361.1	7,459.6	98.5	1.3	(57.2)
Less: Refunds	(1,550.5)	(1,605.1)	(54.6)	3.5	35.8
Net Income Tax Collections	5,810.6	5,854.5	43.9	0.8	(21.4)
Less: Earmarking to SAF	(1,847.8)	(1,893.4)	(45.6)	2.5	17.7
Campaign Fund	(1.9)	(1.5)	0.4	(21.1)	0.0
Net Income Tax to GF/GP	$3,960.9	$3,959.6	$ (1.3)	(0.0)%	$ (3.7)
Other Taxes					
Single Business Tax	1,842.9	1,786.3	(56.6)	(3.1)	(58.8)
Sales	63.6	103.0	39.3	61.8	(3.7)
Use	819.6	878.3	58.7	7.2	21.8
Cigarette	289.2	241.7	(47.5)	(16.4)	(10.0)
Insurance Co. Premiums	231.1	221.0	(10.1)	(4.4)	(26.0)
Telephone & Telegraph	124.2	101.3	(22.9)	(18.4)	(19.3)
Estate	98.6	76.0	(22.6)	(22.9)	11.0
Oil & Gas Severance	47.9	54.4	6.5	13.6	(1.6)
Casino Tax	0.0	3.2	3.2	---	(0.4)
All Other	133.4	109.1	(24.3)	(18.2)	(33.2)
Subtotal Other Taxes	$3,650.5	$3,574.2	$ (76.3)	(2.1)%	$(120.3)
Total Nontax Revenue	346.3	434.3	88.0	25.4	122.4
GF/GP REV. AFTER TAX CHANGES	**$7,957.7**	**$7,968.2**	**$ 10.5**	**0.1%**	**$ (1.6)**
SCHOOL AID FUND:					
Baseline Revenue	$10,255.6	$10,425.4	$169.8	1.7%	$ (20.9)
Tax Changes Not In Baseline	459.2	122.7	(336.5)	(73.3)	7.3
Revenue After Tax Changes:					
Sales Tax	4,681.4	4,719.1	37.8	0.8	(27.5)
Lottery Revenue	586.0	644.9	58.9	10.1	7.9
State Education Property Tax	2,127.5	1,760.6	(366.9)	(17.2)	15.4
Real Estate Transfer Tax	275.5	314.1	38.6	14.0	16.4
Income Tax	1,847.8	1,893.4	45.6	2.5	(17.7)
Casino Tax	90.9	96.2	5.3	5.8	(2.3)
Other Revenue	1,105.7	1,119.8	14.1	1.3	(5.9)
SAF REVENUE AFTER TAX CHANGES	**$10,714.8**	**$10,548.1**	**$(166.7)**	**(1.6)%**	**$ (13.6)**
BASELINE GF/GP AND SAF	18,199.2	18,461.6	262.4	1.4	(60.7)
Tax & Revenue Changes	473.3	54.7	(418.6)	(88.4)	45.4
GF/GP & SAF REV. AFTER CHANGES	**$18,672.5**	**$18,516.3**	**$(156.2)**	**(0.8)%**	**$ (15.3)**
SALES TAX	$6,422.6	$6,476.4	$ 53.8	0.8%	$ (37.8)

1) Reflects changes not only from the May 2004 estimates, but also from the initial estimates of the revenue impact of the tobacco tax increase, casino tax increase, and several other revenue changes that went into effect after the May 2004 estimates were adopted.

Note: Baseline revenue in this table is based on FY 2002-03 to provide an accurate comparison of the revenue in these two fiscal years.

Table 6

FY 2004-05 REVISED REVENUE ESTIMATES
GENERAL FUND/GENERAL PURPOSE AND SCHOOL AID FUND
(dollars in millions)

	FY 2003-04 Revised Est.	**FY 2004-05 Revised Est.**	**Change from FY 2003-04: Dollar Change**	**Change from FY 2003-04: Percent Change**	**$ Change from 05/04 Consensus[1)]**
GENERAL FUND/GENERAL PURPOSE:					
Baseline Revenue	$8,036.2	$8,181.7	$ 145.5	1.8%	$ (235.6)
Tax Changes Not In Baseline	(68.0)	(334.0)	(265.9)	390.9	(35.2)
Revenue After Tax Changes:					
Personal Income Tax					
Gross Collections	7,459.6	7,494.6	35.0	0.5	(221.8)
Less: Refunds	(1,605.1)	(1,664.9)	(59.8)	3.7	9.9
Net Income Tax Collections	5,854.5	5,829.7	(24.8)	(0.4)	(211.9)
Less: Earmarking to SAF	(1,893.4)	(1,938.8)	(45.5)	2.4	57.7
Campaign Fund	(1.5)	(1.5)	0.0	0.0	0.0
Net Income Tax to GF/GP	$3,959.6	$3,889.4	$ (70.3)	(1.8)%	$(154.2)
Other Taxes					
Single Business Tax	1,786.3	1,846.3	60.0	3.4	(97.0)
Sales	103.0	133.6	30.6	29.7	(2.3)
Use	878.3	903.3	25.0	2.8	15.9
Cigarette	241.7	119.1	(122.6)	(50.7)	0.0
Insurance Co. Premiums	221.0	231.0	10.0	4.5	(30.0)
Telephone & Telegraph	101.3	96.6	(4.7)	(4.6)	(24.0)
Estate	76.0	39.5	(36.5)	(48.0)	5.5
Oil & Gas Severance	54.4	60.0	5.6	10.3	10.0
Casino Tax	3.2	42.9	39.7	1,240.6	0.0
All Other	109.1	137.7	28.6	26.2	(21.1)
Subtotal Other Taxes	$3,574.2	$3,609.9	$ 35.7	1.0%	$(143.1)
Total Nontax Revenue	434.3	347.9	(86.4)	(19.9)	26.0
GF/GP REV. AFTER TAX CHANGES	**$7,968.2**	**$7,847.2**	**$(120.9)**	**(1.5)%**	**$(271.3)**
SCHOOL AID FUND:					
Baseline Revenue	$10,425.4	$10,689.6	$264.2	2.5%	$(184.7)
Tax Changes Not In Baseline	122.7	129.0	6.2	5.1	13.3
Revenue After Tax Changes:					
Sales Tax	4,719.1	4,871.6	152.4	3.2	(101.2)
Lottery Revenue	644.9	615.9	(29.0)	(4.5)	(21.1)
State Education Property Tax	1,760.6	1,859.7	99.1	5.6	0.0
Real Estate Transfer Tax	314.1	310.0	(4.1)	(1.3)	17.0
Income Tax	1,893.4	1,938.8	45.5	2.4	(57.7)
Casino Tax	96.2	97.9	1.7	1.8	(1.4)
Other Revenue	1,119.8	1,124.4	4.6	0.4	(7.2)
SAF REVENUE AFTER TAX CHANGES	**$10,548.1**	**$10,818.3**	**$270.2**	**2.6%**	**$(171.6)**
BASELINE GF/GP AND SAF	18,461.6	18,871.3	409.7	2.2	(420.2)
Tax & Revenue Changes	54.7	(205.7)	(260.4)	---	(22.6)
GF/GP & SAF REV. AFTER CHANGES	**$18,516.3**	**$18,665.6**	**$149.3**	**0.8%**	**$(442.8)**
SALES TAX	6,476.4	6,685.6	209.2	3.2	(138.2)

1) Reflects changes not only from the May 2004 estimates, but also from the initial estimates of the revenue impact of the tobacco tax increase, casino tax increase, and several other revenue changes that went into effect after the May 2004 estimates were adopted.

Note: Baseline revenue in this table is based on FY 2002-03 to provide an accurate comparison of the revenue in these two fiscal years.

COMPLIANCE WITH STATE REVENUE LIMIT

Based on the SFA's revised revenue estimates for FY 2003-04 and FY 2004-05, it is estimated that State revenue subject to the constitutional revenue limit will remain well below the revenue limit in each of these fiscal years. The revised estimates of the State's compliance with the revenue limit for FY 2003-04 and FY 2004-05 are presented in Table 7.

FY 2003-04

In FY 2003-04, it is estimated that revenue subject to the limit will total $24.0 billion and the revenue limit will total $28.8 billion. As a result, it is estimated that revenue will fall below the revenue limit in FY 2003-04 by $4.8 billion.

FY 2004-05

Based on the SFA's revised revenue estimates for FY 2004-05, it is estimated that revenue subject to the revenue limit will total $24.3 billion. Based on Michigan's personal income for 2003, the revenue limit will total $29.8 billion. As a result, revenue is expected to fall below the revenue limit by $5.5 billion in FY 2004-05.

Table 7

STATE'S COMPLIANCE WITH CONSTITUTIONAL REVENUE LIMIT
Section 26 of Article IX of the State Constitution
(millions of dollars)

	FY 2001-02 Final	FY 2002-03 Final	FY 2003-04 Estimate	FY 2004-05 Estimate
Revenue Subject to Limit:				
Revenue:				
General Fund/General Purpose (baseline)	$8,280.1	$7,943.6	$8,036.2	$8,181.7
Revenue Sharing (baseline)	1,517.3	1,598.0	1,580.6	1,615.0
School Aid Fund (baseline)	10,105.3	10,255.6	10,425.4	10,689.6
Transportation Funds	2,172.4	2,206.8	2,403.2	2,500.0
Other Restricted Non-Federal Aid Revenue	1,260.8	1,636.7	1,602.5	1,602.6
Adjustments:				
GF/GP Federal Aid	(24.7)	(47.2)	(60.2)	(40.0)
GF/GP Balance Sheet Adjustments	201.7	8.9	(102.1)	(334.5)
SAF Balance Sheet Adjustments	33.1	459.2	122.7	129.0
Total Revenue Subject to Limit:	$23,546.0	$24,061.6	$24,008.3	$24,343.4
Revenue Limit:				
Personal Income:				
Calendar Year	**CY 2000**	**CY 2001**	**CY 2002**	**CY 2003**
Amount	$289,390	$297,609	$303,745	$314,460
Revenue Limit Ratio	9.49%	9.49%	9.49%	9.49%
Revenue Limit	$27,463.1	$28,243.1	$28,825.4	$29,842.3
1% of Limit	274.6	282.4	288.3	298.4
Amount Under (Over) Limit	$3,917.1	$4,181.5	$4,817.1	$5,498.9

CY = Calendar Year

ESTIMATE OF YEAR-END BALANCES

Based on the economic and revenue estimates outlined earlier in this report, along with enacted and projected State appropriations, the Senate Fiscal Agency (SFA) has revised its estimates of the FY 2003-04 and FY 2004-05 General Fund/General Purpose (GF/GP) and School Aid Fund (SAF) year-end balances. The continued weakness in the current level of employment in the State and projections for future employment growth have resulted in significant downward revisions of estimated State revenue. Coupling these revised revenue estimates with enacted and projected State appropriations will lead to significant projected deficits in the FY 2004-05 GF/GP and SAF budgets. The Senate Fiscal Agency is now estimating that the FY 2004-05 GF/GP budget is in deficit by $345.5 million and the FY 2004-05 SAF budget is in deficit by $232.4 million. It will be necessary for the Governor and the Legislature to explore options to eliminate these projected budget deficits over the next few weeks.

GENERAL FUND/GENERAL PURPOSE YEAR-END BALANCES

The State's 2003-04 fiscal year officially ended on September 30, 2004. The process of the final accounting of FY 2003-04 revenue and expenditures is still under way and is expected to be completed by December 30, 2004. This final accounting process involves discussions between the Office of Financial Management in the Department of Management and Budget and the Office of the Auditor General. Until this final accounting is completed, there is no assurance of the actual level of revenue and expenditures for the fiscal year. Based on revenue and expenditure data as of November 29, 2004, the SFA believes that when a final accounting of FY 2003-04 GF/GP revenue and expenditures is completed, the year will close with a $21.7 million balance. Table 8 provides a summary of this estimated year-end balance.

This positive year-end balance will be occurring in spite of the fact that actual tax collections credited to the GF/GP budget were $124.0 million below the levels assumed in the May 2004 consensus revenue estimate. This decline in tax revenue was offset by an unanticipated increase in nontax revenue credited to the GF/GP budget and a higher-than-anticipated level of year-end GF/GP appropriation lapses. The actual final level of the FY 2003-04 GF/GP year-end balance will be transferred to the Budget Stabilization Fund pursuant to Public Act 309 of 2004.

It now appears that the final level of FY 2003-04 GF/GP revenue will total $8.7 billion. Included in this total revenue collection are the following: $174.0 million of surplus revenue carried forward from FY 2002-03, $7.97 billion of base revenue collections, $10.0 million transferred from the Employment Security Fund, $275.9 million from reductions in the level of revenue sharing payments below the statutorily required levels, $169.0 million of one-time Federal funding, $31.0 million from work project lapses provided in Executive Order 2003-23, $69.9 million of restricted revenue lapses provided in Executive Order 2003-23, and $4.1 million of lapsed airport improvement funds.

While the actual level of FY 2003-04 GF/GP tax collections fell by 1.0% from the prior-year level, nontax revenue credited to the FY 2003-04 GF/GP budget exceeded the year-ago level by 25.4%. This unanticipated increase in nontax revenue centered on three areas: Federal aid credited to the GF/GP budget exceeded previous estimates by approximately $27.5 million; revenue transferred from the Liquor Purchase Revolving Fund exceeded previous estimates by $19.4 million; and revenue transferred from escheated property exceeded the previous estimates by $46.2 million. The SFA believes that a large amount of this unanticipated growth in these nontax revenue sources is one-time in nature and will not continue into FY 2004-05.

On the expenditure side of the FY 2003-04 GF/GP budget ledger, the SFA now is estimating that final expenditures will total $8.68 billion. This final level of expenditures is based on actual appropriations and an appropriation lapse of $89.9 million. This level of year-end appropriation lapses is approximately $20 million higher than previous estimates assumed in the budget. This combination of actual revenue and expenditures will lead to the $21.7 million FY 2003-04 GF/GP year-end balance. Pursuant to Public Act 309 of 2004, the actual level of the FY 2003-04 GF/GP year-end balance is appropriated and transferred to the Budget Stabilization Fund.

Table 8

FY 2003-04
GENERAL FUND/GENERAL PURPOSE
REVENUE, EXPENDITURES, AND YEAR-END BALANCE
(millions of dollars)

	SFA Estimate
Revenue:	
Beginning Balance	$ 174.0
Ongoing Revenue Estimate	7,968.2
Other Revenue Adjustments:	
Transfer from Employment Security Fund (P.A. 84 of 2003)	10.0
Revenue Sharing Reductions	275.9
Unrestricted Federal Aid	169.0
Executive Order 2003-23 (Work Project Lapse to GF/GP)	31.0
Executive Order 2003-23 (Restricted Revenue Lapse to GF/GP)	69.9
Lapse of Prior-Year Airport Improvement Funds (P.A. 237 of 2003)	4.1
Total Other Revenue Adjustments	$559.9
Total Estimated Revenue	**$8,702.1**
Expenditures:	
Enacted Appropriations	$8,886.4
Supplemental Appropriations:	
Supplemental Appropriations (P.A. 173 of 2003)	0.5
Supplemental Appropriations GF/GP to SAF (P.A. 236 of 2003)	45.6
Supplemental Appropriations (P.A. 237 of 2003)	81.4
Supplemental Appropriations (P.A. 46 of 2004)	0.1
Supplemental Appropriations GF/GP to SAF (P.A. 185 of 2004)	50.1
Supplemental Appropriations (P.A. 309 of 2004)	(76.2)
Supplemental Appropriations (P.A. 360 of 2004)	(16.7)
Executive Order 2003-23 (GF/GP Reductions)	(200.9)
Projected Net Appropriation Lapses	(89.9)
Total Estimated Expenditures	**$8,680.4**
Preliminary Year-End Balance	**$21.7**
Transfer to Budget Stabilization Fund (P.A. 309 of 2004)	**$21.7**
Final Year-End Balance	**$0.0**

Table 9 provides a summary of the Senate Fiscal Agency's estimate of a $345.5 million FY 2004-05 GF/GP budget deficit. This deficit results from a significant downward revision in estimated revenue coupled with a modest adjustment on the expenditure side of the budget dealing with projected State Medicaid expenditures.

Table 9

FY 2004-05 GENERAL FUND/GENERAL PURPOSE REVENUE, EXPENDITURES, AND YEAR-END BALANCE (millions of dollars)	
	SFA Estimate
Revenue:	
Beginning Balance	$ 0.0
Ongoing Revenue:	
Revenue Estimate	7,847.2
Revenue Sharing Freeze	307.8
County Revenue Sharing Payment Suspension	182.3
Interfund Borrowing Costs Adjustment	20.0
Pharmaceutical Tax Credit Adjustment	10.0
Subtotal Ongoing Revenue	$8,367.3
Non-Ongoing Revenue:	
Sale of Surplus Northville Property	52.0
Sale of Surplus School Forest Land	18.0
Sale of Fairlawn Surplus Property	2.6
Sale of Maxey Center Surplus Property	2.9
Sale of Macomb/Oakland Center	1.9
Sale of Detroit Plaza Building	6.0
Juror Compensation Fund Balance Transfer	4.0
General Tobacco Settlement Transfer	7.0
Judicial Technology Improvement Fund Transfer	1.0
Subtotal Non-Ongoing Revenue	$ 95.4
Total GF/GP Revenue	**$8,462.7**
Expenditures:	
Enacted GF/GP Appropriations	$8,699.4
Capital Outlay Target Appropriation	6.0
Supplemental Appropriations (P.A. 352 of 2004)	43.0
Supplemental Appropriations (P.A. 358 of 2004)	8.5
Projected Medicaid Funding Shortfall	52.0
Lapse from Building Occupancy Charges	(0.7)
Total GF/GP Expenditures	**$8,808.2**
Projected Year-End Balance	**$ (345.5)**

On the revenue side of the FY 2004-05 GF/GP budget ledger, revenue is estimated to total $8.46 billion. This represents a decline of $294.0 million in the level of total revenue assumed in the enacted budget. This decline in the revenue estimate can be attributed to revisions in the SFA forecast of tax revenue based on the current poor economic performance of the State. Of the estimated FY 2004-05 GF/GP revenue of $8.46 billion, the SFA would characterize $8.37 billion as ongoing revenue and the remaining $95.4 million as one-time sources of revenue. The one-time sources of revenue built into the budget include revenue generated from the sale of surplus State property, restricted fund revenue transfers, and the transfer of tobacco settlement funding.

The current estimate of FY 2004-05 GF/GP revenue of $8.46 billion represents a decline of $239.4 million or 2.8% from the projected final level of FY 2003-04 GF/GP revenue. The FY 2004-05 GF/GP revenue estimate of $8.46 billion is $476.0 million or 5.3% below the actual level of FY 2002-03 GF/GP revenue. This two-year drop in State GF/GP revenue has put significant stress on the State budget.

On the expenditure side of the FY 2004-05 GF/GP budget ledger expenditures are projected to equal $8.81 billion. This includes the current level of enacted FY 2004-05 GF/GP appropriations, a projection of appropriations for the Capital Outlay appropriation bill still pending in the Legislature, and a $52.0 million supplemental appropriation need in the Medicaid budget. This supplemental appropriation will be necessary based on current Medicaid spending policies, coupled with the changes in Medicaid caseloads resulting from changes in the short-term Michigan economic forecast.

This comparison of FY 2004-05 GF/GP revenue and expenditures leads to a $345.5 million projected budget deficit. The deficit equates to 3.9% of the estimated level of FY 2004-05 GF/GP appropriations. It is anticipated that over the next two months the Governor and the Legislature will take action to eliminate this projected budget deficit.

SCHOOL AID FUND YEAR-END BALANCES

Table 10 provides a summary of the current SFA estimate of a $35.5 million FY 2003-04 SAF year-end deficit. The actual level of the year-end balance will not be determined until a final accounting of FY 2003-04 SAF revenue and expenditures is completed by December 30, 2004. Based on revenue and expenditure data available as of November 29, 2004, the SFA is assuming that the $35.5 million deficit will exist and will be carried forward as a negative revenue item in the FY 2004-05 SAF budget.

Table 10

FY 2003-04
SCHOOL AID FUND
REVENUE, EXPENDITURES, AND YEAR-END BALANCE
(millions of dollars)

	SFA Estimate
Revenue:	
Beginning Balance	$ 113.7
Ongoing Revenue Estimate	10,548.1
Other Revenue Adjustments:	
General Fund/General Purpose Grant	282.1
General Fund/General Purpose Grant (P.A. 236 of 2003)	45.6
General Fund/General Purpose Grant (P.A. 185 of 2004)	50.1
Federal Aid	1,316.7
Subtotal Other Revenue Adjustments	$ 1,694.5
Total Estimated Revenue	**$12,356.3**
Expenditures:	
Enacted Appropriations (P.A. 521 of 2002)	$12,696.9
Supplemental Appropriations (P.A. 158 of 2003)	(92.8)
Supplemental Appropriations (P.A. 236 of 2003)	2.7
Homestead Exemption Audit (P.A. 105 of 2003)	(50.7)
School Aid Proration Reduction ($74 per pupil)	(131.1)
Projected Appropriation Lapses	(33.2)
Total Estimated Expenditures	**$12,391.8**
Projected Year-End Balance	**$ (35.5)**

On the revenue side of the FY 2003-04 SAF budget ledger, the SFA now is estimating that revenue will total $12.36 billion. This represents a decline of $13.6 million from the May 2004 SAF consensus revenue estimate. On the expenditure side of the FY 2003-04 SAF budget ledger, the

SFA now is estimating that actual expenditures will total $12.39 billion. This represents a modest increase from the previous estimates of actual expenditures.

Combining the SFA's estimate of a $35.5 million SAF deficit carried forward from FY 2003-04 and revised estimates of FY 2004-05 SAF revenue and expenditures leads to a projected FY 2004-05 SAF deficit of $232.4 million. Table 11 provides a summary of the details behind this projected budget deficit. The projected FY 2004-05 SAF budget deficit can be entirely attributed to a $232.5 million reduction in estimated revenue below the amount that was assumed in the initial FY 2004-05 SAF budget. This revenue drop consists of the $35.5 million deficit carried forward from FY 2003-04 and a $197.0 million drop in the estimate of FY 2004-05 SAF revenue.

Table 11

FY 2004-05
SCHOOL AID FUND
REVENUE, EXPENDITURES, AND YEAR-END BALANCE
(millions of dollars)

	SFA Estimate
Revenue:	
Beginning Balance	$ (35.5)
Ongoing Estimated Restricted Revenue	10,818.3
Other Revenue Adjustments:	
GF/GP Grant	165.2
Federal Aid	1,353.6
Reimbursement for Local Tax Collections	(4.6)
Payment in Lieu of Taxes	(2.0)
Subtotal Other Revenue Adjustments	1,512.2
Total Estimated Revenue	**$12,295.0**
Expenditures:	
Initial Appropriations	$12,527.4
Appropriation Lapse	0.0
Total Estimated Expenditures	**$12,527.4**
Projected Year-End Balance	**$ (232.4)**

Note: A proration of $131 per pupil would be required to eliminate projected deficit.

The Governor and the Legislature have several options that might be used to eliminate this projected FY 2004-05 SAF budget deficit. Pursuant to the State School Aid Act, the Governor would notify the Legislature of the actual level of the projected SAF deficit and then would order a pro-rata reduction in SAF appropriations to eliminate the projected deficit. This pro-rata reduction would equal $131 per pupil based on the SFA's estimated deficit of $232.4 million. The pro-rata reduction would take place 30 days following the notification by the Governor unless the Governor and the Legislature enacted an alternative plan to eliminate the projected budget deficit. An alternative deficit reduction plan could include any combination of increased revenue to the SAF or specific reductions in SAF appropriations. If a pro-rata reduction of $131 per pupil is implemented to eliminate the projected budget deficit, it will be up to individual local school districts to adjust their current-year budgets to deal with the resulting loss of State aid.